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No. 97-1075

In the Supreme Court of the United States

OCTOBER TERM, 1997

AMERITECH CORPORATION, ET AL., CROSS-PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES

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ISSUES PRESENTED

1. Whether the Federal Communications Commission reasonably construed 47 U.S.C. 251(c)(3), which entitles "any requesting telecommunications carrier" to obtain access to unbundled elements of the incumbent carrier's network, to permit requesting carriers to obtain access to such elements as a means of providing telecommunications services whether or not they have constructed some facilities of their own.

2. Whether the Commission reasonably determined that, under 47 U.S.C. 153(29), vertical switching functions—such as caller identification and call forwarding—are "features" and "functions" of the switch that fall within the scope of a requesting carrier's right of unbundled access to the switching element.

TABLE OF CONTENTS

	Page
Opinion below	1
Jurisdiction	2
Statement	2
Discussion	7
Conclusion	18

TABLE OF AUTHORITIES

Cases and administrative decisions:

Chevron U.S.A. Inc. v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) 15

Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, In re:

First Report and Order, 11 FCC Rcd. 15,499 (1996) ..... *passim*

Third Order on Reconsideration, FCC 97-295 (Aug. 18, 1997), petitions for review pending, *Southwestern Bell Tel. Co.* v. *FCC*, Nos. 97-3389, et al. (8th Cir.) 13

Statutes and regulations:

Communications Act of 1934, 47 U.S.C. 151 *et seq.*:

47 U.S.C. 153(29) (Supp. II 1996) 3, 4, 5, 6, 16

47 U.S.C. 153(46) (Supp. II 1996)..... 9

47 U.S.C. 251(c) (Supp. II 1996)..... 14

47 U.S.C. 251(c)(3) (Supp. II 1996)..... *passim*

47 U.S.C. 251(c)(4) (Supp. II 1996)..... 8, 16

47 U.S.C. 251(c)(6) (Supp. II 1996)..... 9

47 U.S.C. 252(d)(1) (Supp. II 1996)..... 6

47 U.S.C. 254 (Supp. II 1996)..... 6, 11, 12

Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ..... *passim*

Regulations—Continued: Page

47 C.F.R.:
Section 51.307(c) 4
Section 51.315(b) (Rule 315(b)) 5, 7, 14, 15
Section 51.319(c)(1)(i)(C) 4

Miscellaneous:

H.R. Rep. No. 204, 104th Cong., 1st Sess. (1995) 8

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OPINION BELOW

The principal opinion of the court of appeals (Pet. App. 1a-67a), as amended by the court's order on rehearing (*id.* at 69a-72a), is reported at 120 F.3d 753. The First Report and Order of the Federal Communications Commission (FCC) is reported at 11 FCC Rcd. 15,499 (1996). Excerpts of the First Report and Order are printed in the appendix to the petition (Pet. App.) in *AT&T Corp., et al.* v. *Iowa Utilities Board, et al.*, No. 97-826 (filed Nov. 17, 1997), and in the appendix to the cross-petition (Cross-Pet. App.).

JURISDICTION

The judgment of the court of appeals was entered on July 18, 1997. A subsequent order in this case, granting rehearing in part and denying rehearing in part, was issued on October 14, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

On November 19, 1997, the FCC and the United States filed a petition for certiorari (Fed. Pet.) in *Federal Communications Commission, et al.* v. *Iowa Utilities Board, et al.*, No. 97-831. That petition, along with the petitions of several other parties, seeks review of the court of appeals decision at issue in this conditional cross-petition. Our petition sets forth the statutory scheme and the procedural background of this case in detail, see Fed. Pet. 2-11, and we incorporate that discussion by reference.

1. In enacting the 1996 Act, Congress recognized that, at least with current technology, no carrier seeking to enter the local telephone market could hope to build its own facilities replicating the existing network infrastructure and that, in many circumstances, such duplication would be economically wasteful. See Fed. Pet. 4-5, 7; pp. 8, 12, *infra*. Congress therefore gave new entrants not just a right to "interconnect" facilities that they own with those of incumbent local exchange carriers (LECs), but also broad rights of "nondiscriminatory access to [the incumbent's] network elements on an unbundled basis." 47 U.S.C. 251(c)(3). The Act defines "network element" as "a facility or equipment used in the provision of a telecommunications service," and adds that "[s]uch term also includes features, functions, and

capabilities that are provided by means of such facility or equipment." 47 U.S.C. 153(29).

The cross-petition challenges two aspects of the Commission's implementation of Section 251(c)(3). In the first determination at issue here, the Commission rejected arguments, advanced by cross-petitioners and other parties, that Section 251(c)(3) contains an unspoken "requirement that carriers must own or control some of their own local exchange facilities before they can purchase and use unbundled elements to provide a telecommunications service." Pet. App. 242a. The Commission found that any such "facilities ownership" limitation is foreclosed by the plain language of Section 251(c)(3), which "is cast exclusively in terms of obligations imposed on incumbent LECs, and * * * does not discuss, reference, or suggest a limitation or requirement in connection with the right of new entrants to obtain access to unbundled elements." *Ibid.*

The Commission further explained that the absence of a facilities ownership requirement in the text is no accident: "Congress did not intend to limit access to unbundled elements in this manner[,] because such a limit would seriously inhibit the ability of potential competitors to enter local markets through the use of unbundled elements, and thus would retard the development of local exchange competition." Pet. App. 243a. Indeed, the Commission observed, "it would not be possible to identify the elements carriers must own without creating incentives to build inefficient network architectures that respond not to marketplace factors, but to regulation. * * * Moreover, if we imposed a facilities ownership requirement that attempted to avoid these competitive pitfalls, it would

likely be so easy to meet it would ultimately be meaningless." *Id.* at 248a.

The Commission also rejected arguments (see Pet. App. 243a) that reading a facilities ownership requirement into the text of the Act is necessary "to give meaning and effect to section 251(c)(4)," which gives new entrants the right to resell an incumbent LEC's retail services (see Fed. Pet. 5). The Commission explained that resale and unbundled access to network elements constitute distinct competitive strategies that "present different opportunities, risks, and costs in connection with entry into local telephone markets," and it is therefore "unnecessary to impose a limitation on the ability of carriers to enter local markets under the terms of section 251(c)(3) in order to ensure that section 251(c)(4) retains functional validity as a means to enter local phone markets." Pet. App. 244a; see *id.* at 244a-246a.

In the second determination at issue in this cross-petition, the Commission rejected arguments that "vertical switching features"—*i.e.*, features of the switching element such as call waiting and caller identification (see Cross-Pet. App. 11a-12a; First Report and Order ¶ 414)—"should be classified exclusively as retail services, available to competing providers only through the resale provision of section 251(c)(4)." Cross-Pet. App. 12a; see 47 C.F.R. 51.307(c), 51.319(c)(1)(i)(C). The Commission found those arguments foreclosed by 47 U.S.C. 153(29), which "defines network element as 'a facility or equipment used in the provision of a telecommunications service' and 'the features, functions, and capabilities that are provided by means of such facility or equipment.' Vertical switching features, such as call waiting, are provided through operation of hardware

and software comprising the 'facility' that is the switch, and thus are 'features' and 'functions' of the switch." Cross-Pet. App. 12a (footnote omitted; quoting 47 U.S.C. 153(29)). The Commission added that, "[i]f we were to conclude that any functionality sold directly to end users as a service, such as call forwarding or caller ID, cannot be defined as a network element, then incumbent LECs could provide local service to end users by selling them unbundled loops and switch elements, and thereby entirely evade the unbundling requirement in section 251(c)(3)." *Id.* at 8a.

2. On review, the court of appeals vacated certain of the Commission's rules relating to unbundled access, including Rule 315(b), 47 C.F.R. 51.315(b), which bars incumbent carriers from physically disconnecting previously combined elements, against the wish of a requesting carrier, solely to impose on that carrier the costs of reconnection. (We have sought this Court's review of that aspect of the court's ruling. See Fed. Pet. 25-28.) Nonetheless, the court affirmed both of the Commission's determinations at issue in this cross-petition.

First, in upholding the Commission's rejection of a "facilities ownership" rule, the court agreed that "the plain language of subsection 251(c)(3) indicates that a requesting carrier may achieve the capability to provide telecommunications services completely through access to the unbundled elements of an incumbent LEC's network. Nothing in this subsection requires a competing carrier to own some portion of a telecommunications network before being able to purchase unbundled elements. To the contrary, this subsection imposes a duty on incumbent LECs to provide unbundled access 'to *any* requesting tele-

communications carrier for the provision of a telecommunications service.'" Pet. App. 55a.

The court also affirmed the Commission's policy determination that adherence to the plain language of Section 251(c)(3) would "preserve resale as a meaningful alternative" for many carriers, because unbundled access often requires "up-front investment[s]," and therefore financial risks, that resale does not. Pet. App. 56a. The court added that its "decision requiring the requesting carriers to combine the elements themselves increases the costs and risks associated with unbundled access * * * and simultaneously makes resale a distinct and attractive option." *Id.* at 56a-57a. The court rejected arguments that the availability of unbundled elements at cost-based rates, see 47 U.S.C. 252(d)(1), would defeat a supposed congressional intent to keep new entrants from winning over customers who have traditionally paid above-cost rates to subsidize universal service. Indeed, the court held, the success of competing carriers in appealing to such customers "is entirely consistent with the Act's purpose to promote competition in local phone markets," and Congress has directly addressed any concerns about universal service by enacting 47 U.S.C. 254, which "overhaul[s] the current system" of hidden subsidies. Pet. App. 57a & n.34.

The court separately upheld the Commission's determination that "vertical switching features" are included within the switching element, and that new entrants that have obtained access to the switch are therefore also entitled to obtain access, under the terms of Section 251(c)(3), to the vertical features of the switch. Pet. App. 44a-45a. The court explained that, for purposes of 47 U.S.C. 153(29), "caller I.D.,

call waiting, and call forwarding are vertical 'features' that are provided through the switching hardware and software that are also used to transmit calls across phone lines." *Id.* at 44a. The court further observed that, "[w]hile subsection 251(c)(4) does provide for the resale of telecommunications services, it does not establish resale as the exclusive means through which a competing carrier may gain access to such services." *Id.* at 45a. Thus, the court held, the Act gives a competing carrier the "option of gaining access to features of an incumbent LEC's network through either unbundling or resale." *Ibid.* The court further noted its agreement with the Commission's determination that a contrary analysis "would allow the incumbent LECs to evade a substantial portion of their unbundling obligation under subsection 251(c)(3)." *Ibid.*

DISCUSSION

As the court of appeals correctly determined, the text and underlying purposes of the 1996 Act foreclose both of the challenges presented in the cross-petition. With respect to the first of those challenges, however, the court supplemented its textual analysis with policy considerations that (as clarified in the court's order on reconsideration) rested in part on the court's separate invalidation of Rule 315(b). Because we and other parties have sought review of the court's disposition of Rule 315(b), we do not oppose cross-petitioners' position that, if this Court grants review on that issue, it should also grant review of the first question presented in the cross-petition. This Court should deny the cross-petition with respect to the second question presented, however, because that question is

not substantially related to the other issues presented in these consolidated cases, because the court of appeals did not view it as so related, and because it does not independently warrant this Court's review.

1. a. Congress passed the 1996 Act to "shift [local telephone] monopoly markets to competition as quickly as possible." H.R. Rep. No. 204, 104th Cong., 1st Sess. 89 (1995). Congress understood, however, that competition could not develop in the foreseeable future if new entrants could provide competitive services only by constructing local facilities of their own: under existing technology, no new entrant, no matter how well-financed, could hope to replicate the existing network infrastructure. See Fed. Pet. 4-5 (describing differences between local and long-distance infrastructure). For that reason, Congress enacted Section 251(c)(3), which broadly enables new entrants to use an incumbent's facilities to provide competing services to end users. Because that entry option permits new entrants to fashion their own innovative services by using those facilities in new ways, and because it permits them to offer end users access to the long-distance network, the rights created by Section 251(c)(3) are far more likely to introduce dynamic competition into local markets than the resale rights created by Section 251(c)(4). Under the latter provision, a new entrant may repackage an incumbent's chosen retail services under its own brand name, but it may not offer its customers either creative new services or, just as important, access to the long-distance network. See Pet. App. 244a-245a.

Cross-petitioners challenge the Commission's refusal to read into Section 251(c)(3) a limitation that does not appear in its text: a limitation that would

prevent "a new entrant, without any facilities of its own," from invoking its otherwise applicable rights of access to network elements "to provide a finished service." Cross-Pet. 16. That challenge is without merit. As the court of appeals observed (Pet. App. 55a), nothing in the Act requires a new entrant to create a partial network of its own before leasing unbundled elements of the existing network. To the contrary, Section 251(c)(3) compels incumbent LECs to provide unbundled access "to *any* requesting telecommunications carrier for the provision of a telecommunications service" (emphasis added), which the Act elsewhere defines as "the offering of telecommunications for a fee directly to the public * * * regardless of the facilities used," 47 U.S.C. 153(46).[1]

Standing alone, the unqualified textual mandate of Section 251(c)(3) itself forecloses the "facilities own-

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[1] Cross-petitioners contend (Cross-Pet. 18) that an incumbent LEC's duty to make unbundled elements available to requesting carriers "at any technically feasible point," 47 U.S.C. 251(c)(3), somehow grants it a right to withhold some elements that are necessary to provide telecommunications services. That is not so. The quoted language addresses the points of the network at which new entrants may obtain access to elements; it does not require new entrants to own facilities that can be connected to the incumbent's elements. See Pet. App. 242a-243a. Moreover, cross-petitioners' contrary reading proves far too much, because, as the Commission observed, it would bar new entrants not just from providing a service using only the incumbent's elements, but also "from requesting two network elements that are connected to each other." *Id.* at 243a. There is similarly no merit to cross-petitioners' suggestion (Cross-Pet. 18) that Section 251(c)(6), which *entitles* a new entrant to physical collocation with an incumbent's physical facilities (if that is what it seeks), somehow *compels* a new entrant to construct facilities of its own before gaining access to network elements.

ership" rule that cross-petitioners seek. In addition, cross-petitioners' claim lacks merit for the policy reasons identified by the Commission. See pp. 3-4, *supra*. First, their proposed countertextual limitation on the scope of Section 251(c)(3) would "seriously inhibit the ability of potential competitors to enter local markets through the use of unbundled elements, and thus would retard the development of local exchange competition." Pet. App. 243a. Moreover, cross-petitioners presumably seek a facilities-ownership rule that is not "so easy to meet it would ultimately be meaningless." *Id.* at 248a. Such a rule would require a comprehensive body of federal regulation governing the number and kinds of facilities that a new entrant must itself own before it becomes entitled to invoke its unbundled access rights under Section 251(c)(3). Even apart from the severe market distortions that such a regulatory scheme would create—distortions that the Commission cited as an independent basis for rejecting cross-petitioners' position, see *ibid.*—Congress's failure to provide standards for the development of such a scheme anywhere in the 1996 Act confirms that Congress did not intend to limit Section 251(c)(3) in a way that would require such regulation.

Because cross-petitioners cannot reconcile their position with the text of the 1996 Act, they place most of their reliance on several policy arguments. First, they argue that, if taken at face value, Section 251(c)(3) would introduce so much competition into local markets that it would threaten universal service. See Cross-Pet. 6-8, 21. They contend that, unless Section 251(c)(3) is somehow limited, potential competitors would always choose unbundled access

over resale because the former entry option, unlike the latter, entitles new entrants to make use of the existing network infrastructure by means of efficient, cost-based pricing. Access to the network under those terms, cross-petitioners conclude, would often allow new entrants to undersell incumbents in the provision of services to end users who currently pay above-cost prices so that other end users may pay below-cost prices.

That argument is without merit. As the court of appeals recognized, the rapidly unfolding competition that cross-petitioners oppose is precisely what Congress intended in enacting the 1996 legislation. See Pet. App. 57a n.34. Congress also recognized that the introduction of competition, which is by definition efficient and market-oriented, would require replacement of the traditional system of charging above-cost prices to subsidize universal service. Indeed, the competition engendered by the 1996 Act would ultimately compel replacement of that system even if cross-petitioners were correct in contending that Section 251(c)(3) contains a "facilities ownership" limitation. In a provision of the 1996 Act that cross-petitioners conspicuously omit from their discussion, however, Congress addressed that concern by providing for a new universal-service regime that relies not on the hidden, inefficient subsidies that cross-petitioners ostensibly seek to protect, but on explicit and equitable contributions from all telecommunications carriers, including those that provide service through the use of unbundled elements. See 47 U.S.C. 254. As we have elsewhere observed (see Reply Br. in Support of Fed. Pet. 10), the appropriate way to accommodate universal-service concerns after enactment of the 1996 legislation is not to erect arbitrary

new barriers to competition, but to begin fulfilling the mandate of Section 254, as the Commission has done in a separate proceeding. See Pet. App. 57a n.34.

Cross-petitioners also argue that competition based on facilities that new entrants have themselves constructed is so superior to competition based on unbundled network elements that Congress should be understood to have limited access to those elements in ways that it did not explicitly specify in Section 251(c)(3) itself. See, *e.g.*, Cross-Pet. 4-5, 18-19. We disagree. First, as noted above (see p. 8), Congress recognized that, given the prohibitive costs of replicating local network facilities, broad rights of access to the incumbent's network are necessary to ensure short- and mid-term competition in the local market. Moreover, in declining to enact any "facilities ownership" limitation on the scope of Section 251(c)(3), Congress recognized that existing facilities embody enormous economies of scale, and that it would therefore be economically wasteful in many circumstances for competitors to try to duplicate those facilities when providing competitive services. See Pet. App. 137a; see also Fed. Pet. 4-5, 7. For that reason, "it would not be possible to identify the elements carriers must own without creating incentives to build inefficient network architectures that respond not to marketplace factors, but to regulation." Pet. App. 248a. That effect, the Commission noted, "would diminish competition for local telephone services, and thus any local exchange facilities requirement would be inconsistent with the 1996 Act's goals of promoting competition." *Ibid.*

Finally, cross-petitioners argue that Congress could not have intended any construction of Section 251(c)(3) that renders unbundled access such an

effective means of competition that, given the choice, new entrants would regularly choose it over resale as their primary means of providing competitive services. See Cross-Pet. 14, 21-22; see also *id.* at 24. That argument is also unpersuasive. To begin with, nothing in the 1996 Act suggests that Congress intended to create artificial incentives for new entrants to pick resale over unbundled access where the plain language of the 1996 Act permits a choice of either entry option. Although the Act's pricing provisions for unbundled access do make that option more attractive in many circumstances, that is because Congress wished to give full effect to that more dynamic method of introducing competition into local markets. See p. 8, *supra*.

In any event, the Commission's plain-language implementation of Section 251(c)(3) in fact preserves a broad range of circumstances in which new entrants would choose resale as an entry option: *e.g.*, because they wish to provide services to customers that currently pay below-cost prices or because providing competitive services by means of unbundled elements would, unlike resale, present substantial investment risks. See Pet. App. 245a-246a.[2] More generally, as

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[2] Whether or not cross-petitioners are correct in assuming that, under the Third Reconsideration Order, they will ultimately have to offer "shared transport" at usage-sensitive rates (see Cross-Pet. 20-21), the availability of shared transport as a single network element will not eliminate the fundamental competitive trade-offs between unbundled access and resale. See *In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996* (CC Docket No. 96-98), Third Order on Reconsideration, FCC 97-295, ¶ 47 (Aug. 18, 1997), pets. for review pending, *Southwestern Bell Tel. Co.* v. *FCC*, Nos. 97-3389 et al. (8th Cir. filed Sept. 5, 1997). Among

the Commission has explained (Pet. App. 244a-246a), its implementation of Section 251(c) preserves the respective roles of resale and unbundled access as two quite distinct means of entering local markets each with its own advantages and disadvantages, which vary with a particular carrier's circumstances and entry strategies.

b. At bottom, cross-petitioners argue that, read literally, Section 251(c)(3) would introduce so much competition into local markets that it cannot mean what it says, and that the Commission therefore acted unreasonably in refusing to read anti-competitive limitations into the plain language of that provision. Cross-petitioners express no preference, however, as between different countertextual ways of draining Section 251(c)(3) of its intended competitive effects. Thus, they are content to do without a "facilities ownership" limitation so long as they may continue to pull apart previously joined network elements for the sole purpose of inflicting anti-competitive costs on new entrants, see Cross-Pet. 13-14, as the Eighth

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other considerations, all carriers that provide a service entirely through unbundled access, including those that use shared transport, must bear the risk of investing in *all* of the network elements needed to provide service without knowing whether the service will produce enough revenues to cover the total investment. There is also no merit to cross-petitioners' separate suggestion (Cross-Pet. 20 n.14) that the pendency of the Third Reconsideration Order in the Eighth Circuit somehow "weighs against any grant of certiorari" on the validity of Rule 315(b). As we have elsewhere noted (Reply Br. in Support of Fed. Pet. 10 n.7), that proceeding does not revive issues concerning the validity of Rule 315(b), and this case presents the final opportunity for this Court to affirm the validity of that provision, which is crucial to the development of competition in local markets.

Circuit's invalidation of Rule 315(b) now permits. As we have elsewhere discussed, however, the plain language of Section 251(c)(3) no more permits the imposition of such discriminatory costs than it requires facilities ownership as a prerequisite to unbundled access. See Fed. Pet. 24-28; Reply Br. in Support of Fed. Pet. 8-10. And even if the text of Section 251(c)(3) were ambiguous on either of those points, the Commission's interpretation would be entitled to substantial deference. See *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984).

Nonetheless, we agree with cross-petitioners that, as clarified in the order on reconsideration (see Pet. App. 70a-71a), the court of appeals based its rejection of a "facilities ownership" rule not just on the text of Section 251(c)(3)—which alone would be enough to support the court's holding—but also on policy considerations that, in part, presupposed the continued invalidity of Rule 315(b). In particular, the court assumed that Section 251(c)(3) must be construed in a way that "makes resale a distinct and attractive option" in a broad variety of circumstances, and it believed that its decision contributed to that objective by "requiring the requesting carriers to combine the elements themselves" with the effect of "increas[ing] the costs and risks associated with unbundled access." *Id.* at 56a-57a. Again, we disagree with the court's premise, repeated by respondents here, that it is either necessary or appropriate to impair rights under Section 251(c)(3) to create incentives for new entrants to choose resale as an entry strategy. But because the court of appeals characterized its disposition of the first question presented in the cross-petition as related to its disposition of the second

question presented in our petition, we do not oppose cross-petitioners' conditional request to consider the two issues together.

2. In their second question presented, cross-petitioners renew their argument that vertical switching features such as caller identification, call forwarding, and call waiting "should be classified exclusively as retail services, available to competing providers only through the resale provision of section 251(c)(4)." Cross-Pet. App. 12a. That argument is without merit for the reasons identified by the Commission and the court of appeals. See pp. 4-5, 6-7, *supra*. The 1996 Act makes clear that a new entrant's right of access to "network elements" under Section 251(c)(3) includes not just access to a "facility or equipment used in the provision of a telecommunications service"—the passage that cross-petitioners repeatedly quote in isolation (Cross-Pet. 22, 23, 24)—but also access to "features, functions, and capabilities that are provided by means of such facility or equipment." 47 U.S.C. 153(29). As the Commission determined (Cross-Pet. App. 12a), and as the court of appeals confirmed (Pet. App. 44a-45a), vertical switching features fall squarely within that definition.

Cross-petitioners do not address that explicit basis for the court of appeals' conclusion. Instead, they argue only that the Act implicitly precludes new entrants from obtaining under the terms of Section 251(c)(3) any functionality that could be characterized as a retail "service" and would therefore also be available under Section 251(c)(4). See Cross-Pet. 23-24. That is incorrect. As the court of appeals explained, "[w]hile subsection 251(c)(4) does provide for the resale of telecommunications services, it does not establish resale as the exclusive means through

which a competing carrier may gain access to such services," and therefore "a competing carrier may have the option of gaining access to features of an incumbent LEC's network through either unbundling or resale." Pet. App. 45a. The court also noted, and cross-petitioners do not deny, that their contrary interpretation "would allow the incumbent LECs to evade a substantial portion of their unbundling obligation under subsection 251(c)(3)." *Ibid.*; see also Cross-Pet. App. 8a (if "any functionality sold directly to end users as a service * * * [could not] be defined as a network element, then incumbent LECs could provide local service to end users by selling them unbundled loops and switch elements, and thereby entirely evade the unbundling requirement in section 251(c)(3)").

The court of appeals' disposition of this issue was plainly correct, and it does not independently warrant this Court's review. Moreover, the court did not view that disposition as contingent upon any other aspect of its decision, and cross-petitioners do not contend otherwise. For those reasons, we oppose certiorari on the second question presented in the cross-petition.

CONCLUSION

We do not oppose the cross-petition with respect to the first question presented if the Court grants review of the second question presented in our petition in No. 97-831. The cross-petition should be denied with respect to its second question presented.

Respectfully submitted.

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